

Original Paper

Issues and Challenges of Implementing Fiscal Federalism Faced Under the Reform of A Federal State in Nepal

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Abstract

After entering the federalism of Nepal, there was a debate about how the budget transfer would be state and local governance for the development of works. In the early days, although the central government would manage the budget, more problems started to appear in the financial transfer process, according to the policy of gradually leaving the responsibility of all the work including infrastructure development and physical construction to the central government. It seems challenging to establish political commitment in the distribution of resources according to the division of powers in the federal system. Instead of transferring resources, the tendency to centralize resources and manage the work of other levels of government by themselves has not gone away. In the top leadership, the tendency to understand federalism as decentralization rather than division of state power between the levels of government prevails. The second challenge of fiscal federalism is the balance, clarity and inter-level cooperation between the levels of government in matters of taxation and revenue. The revenue source at the state level is very low. All levels of government have distributive allocations, high expansion of current expenditure and weak public fiscal accountability. It seems that the allocated efficiency and productivity of public expenditure should be improved. There is no hesitation to rationalize public expenditure by cutting unnecessary expenditure that does not contribute to public services and financial contribution. A balance is needed between the distribution of responsibilities and financial power. For the successful implementation of financial federalism, it is appropriate to give work responsibilities along with spending arrangements. Based on job responsibilities, it is necessary to arrange resources and develop the ability to perform accordingly. A healthy financial system is the backbone for the successful and proper implementation of federalism in any country. There is no choice but to emulate the federalism of Nepal, which is still a milk child, and move forward with the economic, social and cultural development of the country through a transparent, balanced and

predictable financial federalism. For that, we should consider the national interest as the motto to prepare a suitable or implementable action plan and move forward.

Keywords

fiscal federalism, diversity, province, local government, power sharing, transfer of budget, state policy

1. Background

In the 1603 A.D, Johensa, to make democratic the city state name Indent, the concept was immersed. In the 1661th confederation, the centralized autonomous Roman Empire divided two governments through power into the state turned into a federal state. After that, Montesquieu formed the government through the collection of small states and all states have the right to self determination to create unity in the country to make the state powerful. Through this concept, to make law more central and regional states has emerged. In 1781, to fight against the British, America formed a federal state with thirteen cities. For example, Russia, Brazil and other states such as Belgium, Ethiopia and Spain have centralized government systems.

Nowadays, 192 countries are members of the United Nations. Among them, 28 countries have a federal system. After the addition, there are 29 countries. The first federal system was implemented in Switzerland. Internal strife and civil war Later, from 1848, a federal constitution was formed in the United States. After that, the country gradually adopted the federal system. The number is increasing. The success of federalism in India, America and Russia is a big country with a large population that adopted federalism has been used. In some countries, there is conflict in the countries that have adopted the federal system (UN, 2021).

In Nepal, there is a long practice of a centralized governance system; kings, Rana's regime and political parties managed the governance from the top level. In order to make the people participate in the governance system, the political division of the country was based on 14 zones, 75 districts, 5 development zones, 58 towns and 3915 village development committees. A policy of decentralization was adopted under the Local Self-Government Act 1999 to transfer power to a centralized governance system. If those at the top of the centralized governance system used decentralization only as an appearance, it could not be misused. The direct participation of the people in the process of state policy making and development project management was taken into development works were conducted based on centralized mentality and grain. The state could not embrace the inclusion of social diversity. Aspects like social inequality, unrest, violence, conflict, corruption plagued the state. An environment has been created where citizens express dissatisfaction with the governance process of the country. The foundation of dissatisfaction in the governance process became stronger and because of that, the system itself changed and formed a federal state.

The Constitution of Nepal has incorporated all the above four pillars of fiscal federalism. Jurisdiction at union, state and local level has been determined. All three tiers of government are empowered to levy taxes on matters within their jurisdiction and to collect revenue from those sources. The government of Nepal has made arrangements to distribute the revenue collected to the union, state and local levels fairly. The Government of Nepal has arranged that equalization, conditional, supplementary and special grants should be given to the provinces and local levels and the provinces to the local levels. For the equitable distribution of revenue sources, the results of the financial transfers received by the provinces and local levels are in accordance with the recommendations of the National Natural Resources and Finance Commission. There is a provision that states and local levels can obtain internal loans with the approval of the Government of Nepal.

The federal system in Nepal addresses local government, provincial governments and central government. It has the dominant political trend which allows explicit constitutional guarantees for sub-state authorities and local level. The centralization of state power in Kathmandu also alienates the vast majority of the people from the structures of the state. There is also considerable resentment arising from the belief that this centralization is a strategy for the continued monopolization of power by small elites, based on caste and region. Consequently, many people see federalism as a way to empower communities and regions, which have been marginalized by the centralization of power, through forms of self-government. They also see it as recognition of the religious, linguistic and ethnic diversity of the Nepali people. Federalism can distribute state power among different levels of government, its adjustment between central exploitation and decentralized opportunistic behavior.

The people of Nepal wish to see the unification of the people of Nepal not only geographically, but also with social and economic justice and harmony. People are confident that the system will strengthen the political, economic, social, informational and military harmony among the people. The federal system will provide equal opportunity for all types of people in the state mechanism and also gives greater space for the recognition of identity and the empowerment of marginalized people. The co-existence and brotherhood among the people, which will be the outcome of federalism, creates unity among the people in every sector. The issue of federalism came up after the Maoists launched their armed struggle. They advocated the policy with a view to attracting people of different ethnic groups and succeeded in making it popular to a large extent. Now, people from various walks of life are lauding it. Federalism became Nepal's major political agenda after the Second People's movement in 2007.

In particular, fiscal federalism has four parts. The distribution of expenditure responsibilities, revenue rights, intergovernmental financial transfer. With us, revenue distribution and mobilization and distribution of natural resources are also considered as part of financial federalism. The political, administrative and fiscal dimensions of federalism are closely interrelated. And they are complementary to each other. Political dimensions are common in governance. The inclusive and full participation of the people is essential to the development of human rights. The constitutional dimension has the right to

receive from the state. First-level, professional public service programs provide geographic and financial support. Federalism promotes the rational use of public financial resources. The aim is to have a prosperous life of public finance in the life of the general public. An important restructure is an input unit, the state from which it sources its resources. Those countries that have used it prudently and fairly have achieved economic prosperity. The countries that are leading the market in economic development the market belong to each other.

Fiscal federalism is a financial relationship between units of the federal government which depends upon economic, geo-political and socio-economic development. The aims have achieving political objectives, particularly efficiency, equity, stabilization as well as regional balance, national integrity and political stability (Bid, 2002).

The term of fiscal federalism was first introduced by American economist Richard Musgrave in 1959. It is more important because it deals with division of governmental functions and financial relations between different levels of government (Musgrave, 1959). Fiscal federalism is concerned with the division of revenue for expenditure responsibility between different kinds of government. That is the allocation of taxes and expenditure functions to different sectors of government with different levels of foremost issue (NEA, 2009).

A decentralized body of government is more accessible, sympathetic and quickly responds to local needs. It provided closeness between citizens and governments. It enhances the sense of ownership and responsibility. Fiscal federalism encourages the local population to carefully plan, monitor and protect the result (Boadway & Shah, 2009). The revenue assignment acquisition as a tax policy is known in the context of inter-government-fiscal relation has often considered the second main pillar or building block of fiscal decentralization policy (Bird, 2011).

2. Issue and Objective

In countries based on parliamentary, presidential, unitary and federal government systems in the world, sustainable development, peace and good governance have been achieved on the basis of public participation, public cooperation and public opinion. In some countries with autocratic systems, various speeches are made in the name of the people. At present, about 29 countries of the world have a system of governance with federalism in practice to make citizens responsible for policy making and implementation by using executive, judiciary and managerial rights from the grassroots level.

Federalism is a matter of dividing the entire state's power into two or more units and bringing about a favorable change in the way and thinking and concept of running the state. Federalism is considered to be an extended form of democracy, which maintains people's participation and ownership in the state system through different levels of government for the division and distribution of state power at different levels. A more practical practice of democracy is possible in this. It is considered grassroots of democracy. Federalism aims to maintain independence from the state system through self-governance

and partnership governance. Similarly, it intends to make democracy, inclusiveness, social, cultural transformation and economic development people-oriented responsive to the people. With the implementation of the Constitution (2015) of Nepal, the country has moved to a federal government system.

Federal means having or relating to a system of government in which several states form a unity but remain independent in internal affairs or relating to or denoting the central government as distinguished from the separate units constituting a federation (Persall, Judy, 2000). The application of western democracy in different social, economic and cultural contexts brings conflict and controversy as well as war either internally or externally. Hence, the federal government is suitable for some countries and not for all (Anderson, 2008, p. 12).

Financial federalism has been developed with the belief that power, authority, resources and responsibilities should be given to the closest agency to solve the problems of the state, i.e., citizens, at the doorstep of the citizens. Around the 1960s, financiers such as Richard Musgrave, W. Oates, Richard M. Word, etc. developed financial federalism and defined the relationship between the responsibilities of different levels of government and the mobilization of resources. It determines the work responsibilities and financial relations between different levels of government. Financial federalism is the mechanism by which the government collects money, collects and spends it within the limits, boundaries and procedures of the law. The combined form of expenditure responsibilities, revenue arrangements, revenue rights, resource mobilization and credit at various levels is called financial sustainability.

According to the Constitution of Nepal, identification, distribution, expenditure, records, audit and management of local, provincial and union accumulated funds, utilization of existing natural resources and their equitable distribution can be considered as financial federalism. It is directly related to the issue of revenue generation and distribution of expenditure responsibilities among the governments. The government's search for a role related to each other for fiscal federalism is a main problem of issue.

The most beautiful side of federal democracy, citizens directly participate in engagement in the state activities operation do yes Principle: legal governance, Press freedom, periodically election, suffrage of the majority governance, independent Judiciary, etc. characters of democracy inherent elements are regime in the system of the people to participation all kind of governance in the system Just like that Importance given happens in the world in trend are Parliamentary, Presidential, unitary, associational and despotic in the system including of the people Participation, engagement and support without of development The works speed to take can't Citizens of development conductor and Executive, Judiciary and managerial predecessors use From the bottom up done Policy Construction execution citizen to himself responsible to make currently of the world approx 29 watt in countries Federalism including governance system In execution being is right, responsibility and of responsibility from myself. Implementation done governance arrangement operation to do like this By arrangement to citizens forever responsible and conscious makes to say recognition being is In Nepal Armed with of movement

successful Management 2007. After the movement installed of the republic institutional implementation to federal democratic republican of the state as define after doing federal republic of Nepal original structure union, province and local level to be to the arrangement clearly done is constitution continued after formation having been local layer restructuring of the commission recommendation according to seven province and 753 local level structure construction be in execution.

Fiscal decentralization and local autonomous governance were practiced in Nepal in the past, fiscal federalism has been practiced only after the constitution of Nepal (2015) was promulgated and people's representative institutions became active after the elections, and federalism began to be implemented at different levels of government. The national natural resources and finance commission provided in part 26 of the constitution have codified fiscal federalism components. It can focus on how to address expense responsibility. Revenue rights/responsibilities, inter-governmental financial transfer, internal credit rights and mobilization of natural resources were another problem of the fiscal federation of Nepal. The objectives of the study are interpreted as how to solve the fiscal federalism problems and outcome reform of the federal state of Nepal.

3. Materials and Methods

I have reviewed the related work done previously in this section, such as books, journals, law, protocol and duties of fiscal federalism. These above matters are used both published and unpublished, whatever used. The study focused on secondary sources of information and analytically explained. There was absent primary data on fiscal federalism in Nepal. This paper only reviews to explain fiscal federalism practices in the world's scenario.

The history of federation shows that prominent federal states have been created through two approaches: holding together and coming together. India is a "holding together federalism" in which autonomous kingdoms or units pre-existed and a federation was created to hold them together into a single state, bestowing "residual power" to the federal government. So, the United States, Canada and Switzerland are coming together federalism in which independent states pre-existed, and they came together to create a federation by surrendering their sovereignty. If we look at Nepal's case from these two perspectives, it doesn't fit into any one of these. Because the political parties first created six provinces, and now it has come to be seven, which has sparked off protests and conflict in the plains. It appears that Nepal's case has been more of a created federation in which a unitary state has been sliced up into seven different autonomous sub-national constituent units. The emergence of conflicts and protests in different parts of the country following the demarcation of federal states serves as explicit testimony to just how difficult it is for a multi-ethnic and cultural country to go federal.

Federalism as a state structure in Nepal had been bubbling under the surface for a long time. Already in the middle of the 20th century, efforts were made by the Madhesis in the south of the country to develop a federalist region. As the decades passed, such demands permeated throughout the country, and seemed

to largely have been a reflection of the perceived inequalities between the capital and the countryside. The Maoist insurgency, when it broke out in 1996, included federalism in their 40 point agenda. This seems to have been a Madhesi-influenced move by the Maoists to capitalize on growing discontent to enable a mobilization of armed violence, in particular in rural communities (Bergman, 2011).

Nepal is an underdeveloped country with diverse geography, ethnic groups, linguistic groups and various political parties. Poverty, regional imbalance, improper infrastructure and unemployment remain Nepal's major problems. The idea of a federal structure emerged as a political agenda against the unitary system after the success of the people's movement in 2006. From the experiences of other federal countries, provinces demand additional expenditure as they face new challenges which are also for the newly formed federal government of Nepal (Subedi, 2018).

There are twenty-six countries in the world that have a federal system. Almost in all countries, the federal system has been adopted with the unification of all separate independent states, where the federal system is found successful. Switzerland, America, Canada. But Nepal has been following a unitary system since its tireless effort of unification by Prithvi Narayan Shah. The federal system seems to fail in the countries which have transformed into federal from unitary, such as Sudan, Nigeria and Ethiopia. Thus, transforming a unitary country into a federal country is very unnatural work and Nepal has also applied the same method (Shakya, Purnaman, 2017).

At present, there are seven provincial governments and 761 governments, including 753 local governments, seven provincial governments and one federal government. At present, governments of all levels are functioning without governance in the federal system. It was said that the first phase of the federal system of government was not completed on two occasions. Previously, the calculation of the local level was not completed in three stages. After that, the calculation was not completed in two stages at once for the union and the state. We have 6 Chief Ministers, 11 Deputy Chief Ministers, 276 Chief Ministers and 460 Chief Ministers. At present, there are 165 constituencies in the Progressive Assembly and 330 constituencies in the 77 provinces of Nepal (NFGS, 2021).

Nepali context: The Constitution of Nepal can be considered as a complete guiding document from the point of view of fiscal federalism. Since the Constitution is the basic law, the Intergovernmental Finance Management Act, 2074 and the National Natural Resources and Finance Commission Act, 2074 have been issued and implemented to ensure financial federalism by literally implementing the matters written in it. In the constitution of Nepal, financial federalism and intergovernmental financial management are mentioned. The Constitution mentions the powers and responsibilities of all three levels of government in Schedules 5 to 9 of the Constitution. Similarly, the rights related to revenue are also constitutionally guaranteed. Basically, issues of national concern such as finance, foreign affairs, home administration, defense and overall economic stability and financial stability are considered the responsibility of the central government.

In the constitution, four types of grants are provided under the grants provided to the provincial and local levels: equalization grant, conditional grant, supplementary grant and special grant. According to Article 60 of the Constitution of Federal Nepal, Sub-section (4), the Government of Nepal distributes financial equalization grants to provinces and local levels on the basis of their expenditure needs and revenue capacity. Provisions have been made to distribute the financial equalization grant according to the provincial law based on the revenue raised from its own sources and the expenditure needs of the subordinate local level and the capacity of the revenue.

4. Royalty Sharing of Natural Resources

According to the federal law, a federal accumulated fund should be set up and collected annually into three levels of accumulated funds to distribute the royalties received from natural resources between the government of Nepal, the provinces and the local levels. There was mountaineering, electricity, forestry, minerals, water and other natural resources. On the recommendation of the Finance Commission of Royalty, it has been arranged to distribute and distribute the royalties fairly in proportion to the affected provinces and local levels affected by the use of natural resources.

The national natural resources and finance commission act, 2014, which was drafted to make provisions regarding the national natural resources and finance commission established in accordance with article 250 of the constitution and to make necessary arrangements regarding its work, duties and rights, to bring the meaning of articles 250 and 251 of the constitution to the implementation level. It has been certified by the president of 13th October 2017 and has been implemented mainly as follows. Inter governmental finance management act 2018, protocol section (7) sub section (2) index number 4, related to distribution of royalties and natural resources as:

Table 1. Distribution of Royalties and Natural Resources

S.N	Title of Royalty	Nepal Government	state Government	Local Government
		%	%	%
1	Mountain Climbing	50	25	25
2	Electricity	50	25	25
3	Forest	50	25	25
4	Industry & Minerals	50	25	25
5	Water & Other natural Resources	50	25	25

Source: <https://www.lowcommission.gov.np> (2018).

The federal government has 50% charged of royalties for mountain climbing, electricity, forest, industries & minerals and water & other natural resources. Similarly, the state and Local government has also charged 25% and 25% of royalties for mountain climbing, electricity, forest, industries & minerals and water & other natural resources respectively.

5. Fiscal Federalism Practices in the World

India: India is a federal country based on dual federalism. There are 2 levels of government here, federal and provincial. In India, the local level is under the province. In relation to intergovernmental financial transfer, it appears that articles 275 and 282 of the Constitution of India provide for grants to be provided by the Center and the Center and the Provinces respectively. The nature of the subsidy, how much it will go to and in which area, will be as recommended by the Financial Commission. The constitution of India does not mention the type of subsidy as in the constitution of Nepal. The provision of this commission is made in Article 280 of the Constitution of India. The term of this commission is five years from the date of appointment by the President. There is no constitutional commission like Nepal. Goods and Services Tax (GST) system has been implemented in India since 1st July 2017, replacing the indirect taxes imposed by more than 15 central and state governments.

Equalization subsidy is not practiced in India; however, it is mentioned in the report of the Fourteenth Finance Commission that there is a goal to go towards equalization subsidy. The distribution of the unconditional grant here is done on the basis of formula. For upward revenue distribution, the Fourteenth Finance Commission has recommended 17.5, 10, 50, 15, and 7.5 percent weightage for the index based on population, demographic change, income inequality, area and forest area respectively.

Germany: Germany is one of the countries that have implemented federalism in the world. The federalism here is based on coexistence and cooperation. There are three tiers of government which are autonomous, inter-related and independent. In Article 104 of the Constitution, it is mentioned that the provinces will assist in the work of the Union and do related work.

Article 106(5) mentions that the province can distribute the income tax share to the local level based on the income tax paid by the residents of the respective local level. Similarly, in sub-section 6 of the said article, it is provided that the local level can collect real estate tax, local industry and trade and local excise duty. Article 106 of the Constitution provides for revenue distribution. In Article 106 (8), it is mentioned that the Center will give special facilities to the provinces and localities if the amount received from the revenue and distribution is insufficient due to the burden of expenses. Article 107 of the German Constitution provides for equalization grants. If the corporate income tax raised in any province is less than the average tax raised in all provinces including income tax, equalization subsidy is provided to such province. Its main basis is financial ability and financial need.

South Africa: Like Nepal, South Africa is a country that has adopted federalism based on co-operation and coexistence. Here, three levels of government have been arranged to use state power in an independent and autonomous manner. Under intergovernmental financial management, intergovernmental financial transfer is basically done through grants and revenue sharing. Article 227 of the Constitution states that the central government can give conditional, unconditional and equalization grants to the provincial and local governments. Article of 220 has the constitution mentions that there will be a financial and fiscal commission.

The said commission can determine certain criteria for revenue distribution and grant distribution and recommend to the government. At least 10 months before the beginning of the financial year, the financial commission has to recommend a report on revenue distribution to the central parliament, the Provincial Parliament and the Minister of Finance along with various other issues. Similarly, the revenues raised by the central government are distributed in an equitable manner for the basic works and services handed over to the provinces and local levels. When the central government makes recommendations for revenue distribution to the provinces, it makes recommendations on the basis of the following indicators. For example, in 2013, the formula was based on education (about 51 percent), health (about 26 percent), population (about 14), institutional share (about 5 percent), poverty (3 percent) and gross domestic product (1 percent). It can be taken. In that country, intergovernmental financial management is done through the intergovernmental financial relations Act, 1997.

USA: The United States of America consists of a federal government, fifty state governments, two federacies, three local home-rule territories, three unincorporated territories, over 130 native American domestic dependent nations, and numerous municipal (or local) governments. All of the federal and state governments are organized according to the principle of the separation of executive and legislative powers (Ronald, 1999).

The constitution invests the federal government with a very broad discretionary revenue raising power. Article 1 section (8) states that “the congress shall have power to lay and collect taxes, duties, imposts and excises and provide for the general welfare of the United States”. However, as the federal government’s power to raise taxes is not exclusive, states retain the right to levy taxes and to regulate the taxing powers of local governments. Thus, although there are no shared taxes, more than one order of government may exploit the major revenue sources. For example, both orders of government may levy personal and corporate income taxes, and selective sales taxes. The US has a decentralized tax administration system, with each order of government having its own administrative system to collect the taxes it imposes (Janet& Emil, 1997).

Australia: The Australian Confederation was formed in 1901. It included the Commonwealth Government, the six original colonial state governments and the two self-governing mainland territories. About 900 local bodies are included in it. In order to maintain the federation, the constitution has defined powers with relatively few characteristics for the central government. One of these was the power to levy

customs and the other excise duty. However, it assigned many powers in state administration and revenue collection. This power can be exercised by the Commonwealth together with the States. In the event of conflict, its laws shall prevail. Article 96 of the Constitution stipulates that collecting taxes such as defense, taxation, foreign affairs, social welfare, profit tax, pension, postal, communication, currency, and banking and insurance are among the rights. The Commonwealth Parliament has been empowered to make grants on terms and conditions as it deems fit. The Commonwealth is used to influence sub-national spending patterns and administrative priorities and, in part, through it to influence macroeconomic stability policies. The six original colonial states formed to work together to create a constitution, legal systems, education, health, housing, urban development, has maintained the responsibility of the special legislature for the service sector including road and rail transport, provision of electricity. The constitution has not given any formal recognition to the role of local government in managing gas, water, and industrial activities. It is believed that this standard work of the government comes under the control of the state legislature. In financial and other inter-governmental matters, it is mentioned that only the majority vote of the existing states of the land areas (Northern Territory and Australian Capital Territory) can get full state status (Mathews, Russell L., W.R.C, 1972).

6. Discussion and Findings

Concept of fiscal federalism in Nepal: A fundamental aspect of federal structure is fiscal federalism. Identifying the resources needed for the union, state and local level, allocation, expenditure, records, audit and management of local, state and union coffers is understood as financial federalism. According to the constitution of Nepal, for the use and operation of the powers of the three levels of government, to manage resources and spend to manage. All the three levels should make laws, make budgets, make decisions, prepare and implement policies and plans in terms of their respective jurisdictions, as well as benefit from the use of existing natural resources and their equitable distribution. The constitution clearly mentions the jurisdictions of the three levels of government. Apart from jurisdictions, the implementation of federalism and especially financial federalism has become complex and complicated due to the use of common rights of one or more levels and the laws to be prepared for their implementation. Analyzing on the basis of practice in countries that have adopted federalism, the union is responsible for major infrastructure and policy-making, intermediate and inter-provincial development projects in the field of provincial development, and local level work service delivery and local infrastructure.

Definition of fiscal federalism: In a general sense, the act of organizing economic and financial matters in the constitution, laws and practice is called financial federalism. In fact, it includes matters related to monetary policy, taxation, customs and commerce. As a whole, financial federalism is the mechanism by which the government collects money, collects and spends within the limits, boundaries and procedures of the law. The combined form of various levels of expenditure responsibility, revenue arrangement,

revenue sharing and debt is called integrated financial arrangement. Under the rule of law, all actions must be in accordance with the law. Therefore, fiscal federalism should be implemented in such a way that macroeconomic stability is maintained in accordance with the law, such as revenue mobilization, resource allocation and budget creation.

Dimensions of fiscal federalism: Financial federalism is an important basis for the implementation of federalism. In addition, this financial federalism is also an economic and political issue. The main dimensions of financial management are the involvement and role of the lower level governments regarding the efficient allocation of existing resources. In fact, these dimensions of the implementation of financial federalism are the main basis for the implementation of federalism to make the citizens empowered, responsible, accountable and at the center of the identification and fulfillment of needs.

Although fiscal decentralization and local autonomous governance were practiced in Nepal in the past, fiscal federalism has been practiced only after the constitution of Nepal (2072) was promulgated and people's representative institutions became active after the elections, and federalism began to be implemented at different levels of government. The National Natural Resources and Finance Commission provided in Part 26 of the Constitution have codified the five components of fiscal federalism in Nepal.

Expense responsibility: In the Constitution of Nepal, the responsibilities and powers of the three levels of government have been clarified. In Article 56 (2), it is mentioned that state power shall be exercised by the union, state and local levels. Article 57 divides state power. According to which, the rights of the Union are mentioned in Schedule 5, States in Schedule 6, Union and States in Schedule 7, Local level in Schedule 8 and Common rights of Union, State and Local levels in Schedule 9. The constitution has organized separate economic systems for the exercise of the rights of the union, state and local levels, and has constitutionally guaranteed the financial management functions including the federal accumulated fund, provincial accumulated fund and local accumulated fund, resource mobilization, fund management, expenditure withdrawal system, inspection and testing at those levels.

Revenue Rights/Responsibilities: Article 60 of the Constitution of Nepal provides for the distribution of revenue resources. Similarly, in sub-section (1), it is provided that the union, state and local levels can levy taxes on matters within their economic jurisdiction and collect revenue from those sources. It has been arranged that all three levels of government can collect tax and non-tax revenue according to the constitution and other prevailing laws.

Union's revenue rights: According to schedule 5 of the constitution, customs, excise duty, value added tax, corporate income tax, personal income tax, salary tax, passport fee, visa fee, tourism fee, and service fee penalty fine.

Revenue authority of the province: according to schedule 6 of the constitution, tax on agricultural income, vehicle tax, entertainment tax, advertisement tax, real estate registration fee, tourism, service fee levy, fine.

Revenue rights of local level: According to schedule 8 of the constitution, property tax, house rent tax, vehicle tax, advertising tax, business tax, land tax, entertainment tax, real estate registration fee, service fee, tourism fee, property collection, fine.

Shared revenue rights: Service charges, fines and royalties from natural resources, tourism charges as per Schedule 9 of the Constitution

Non-imposition of taxes: According to Article 115 (1) of the Constitution, the federal government may not impose or collect any tax except in accordance with the law, according to Article 203 (1), the provincial government may impose any tax in the province and according to Article 228 (1) the local government may impose any tax at the local level, except in accordance with the law can't pick up. Likewise, according to Article 236, the provincial and local levels have arranged to do as mentioned in relation to inter-provincial trade.

Intergovernmental Financial Transfer: There are two forms of inter-governmental financial transfer in Nepal: revenue sharing and financial transfer. Provisions regarding this have been made in various sub-sections of Articles 60 and 251 of the Constitution. Under which, in addition to revenue sharing, inter-governmental financial transfers will be made through equalization grants, conditional grants, special grants, and supplementary grants.

Right to Internal Credit: According to the Constitution of Nepal, the right to take foreign aid and loans has been given to the Government of Nepal. With the approval of the government of Nepal, there is a provision that provinces can also take it. According to Article 251 (1) of the Constitution, the national natural resources and finance commission has been given the duty and authority to recommend the limit of internal debt that can be taken by the federal, state and local governments after analyzing macroeconomic indicators.

Utilization of natural resources: In Article 59 (4) of the Constitution, the federal, state and local levels must arrange for the equitable distribution of benefits obtained from the use or development of natural resources, a certain portion of such benefits must be distributed in the form of royalties, services or goods to the project-affected areas and local communities in accordance with the law. Similarly, in Article 251 sub-section (1) (h), (i) and sub-section (2) (3), mainly the National Natural Resources and Finance Commission determines the detailed basis and pattern of revenue distribution among the 3 levels of government, recommends subsidies, macroeconomic indicators After analyzing, recommending the limit of internal debt that can be taken by the 3-level government, suggesting to solve the disputes that may arise related to the distribution of natural resources.

6.1 Legal and Institutional Arrangements

For the successful implementation of federalism, the constitution of Nepal and other laws and institutional mechanisms have been arranged as the legal basis of financial federalism.

Constitution of Nepal: The article (56) Structure of the State of federal democratic republic of Nepal shall be three levels, namely the union, state and local levels. Article 57 distribution of state power:

According to the provisions in schedule 5, 6, 7, 8, 9, and the use of common rights has been arranged in accordance with the constitution and federal, state and local laws. In Article (58), the Union is prescribed to exercise residual rights.

In Article 59 (1), it is ensured that the union, state and local levels make laws, make annual budgets, make decisions, prepare policies and plans and implement them in matters related to the economic rights of their jurisdictions. Article 60 (1) provides that the union, state and local levels can levy taxes on matters within their economic jurisdiction and collect revenue from those sources. Article 232 (1) stipulates that the relationship between the three levels of government shall be based on the principles of cooperation, coexistence and coordination. In Article 250, the provisions of the national natural resources and finance commission and in article 251, the duties and powers of the commission are specified.

Inter-governmental finance management Act 2018: It made to manage the necessary management related to revenue rights, revenue sharing, grants, loans, budget management, public expenditure and financial discipline of the government of Nepal, at state and local level. Among the main provisions of the Act, revenue-related taxes, non-taxes and royalties can be levied, determining the basis of non-taxes. Distribution of value added tax and excise duty, distribution of vehicle tax and distribution of royalties from natural resources, in relation to grants, the Government of Nepal will provide financial equalization grants based on the needs and revenue capacity of the provincial and local levels on the recommendation of the Natural Resources and Finance Commission. The Government of Nepal will provide conditions. There is a provision for giving special grants.

Local government operation Act 2018: Local level property tax on houses or land occupied by houses, land tax on other land, building, shop, garage, roof, roof, factory, land or pool tax on existing amount, can impose business tax on the basis of capital investment or economic transaction, can impose existing tax. The local level of the place where the herbs, was materials and animals are collected has been given the right to levy a tax on these items.

Institutional arrangements: In the implementation of financial federalism, there are all three levels of legislature, executive, judiciary, parliamentary committees, national natural resources and finance commission, office of the auditor general, ministry of finance, office of the comptroller general and other concerned organizations at the union, state and local levels. Similarly, inter-provincial councils, inter-governmental finance councils, provincial coordination councils, district coordination councils, national development problem solving committees, national planning commissions, and public finance management training centers are in place and these organizations play an important role.

Table 2. Estimates of Resources for Fiscal Federalism (Rs billions)

Fiscal Years	Federal GDP	Federal Revenue	State/Local Revenue	Foreign Aid	Internal Debt	Aggregate source
2014/15	2124	405	9	63	42	519
2015/16	2248	482	10	126	88	705
2016/17	2562	566	11	302	111	990
2017/18	2946	651	17	234	88	990
2018/19	3388	749	25	264	102	1139
2019/20	3896	861	37	297	117	1312
2020/21	4481	990	56	334	134	1514
2021/22	5153	1138	84	377	155	1753
2022/23	5962	1309	125	425	178	2037

Source: Ministry of finance, 2020.

Now from the given Table 2, the estimate of resources for fiscal federalism was presented from fiscal years 2014/15 to 2022/23. The federal GDP for the fiscal years 2014/14 was 2124 billion and 2022/24 was 5962 billion, which increased each year. On the other hand, the federal revenue for the first base years 2014/15 was 405 billion and years 1309 billion increased continuously. The ratio of state/local revenue, foreign aid, internal debt and aggregate resources was also increased. All evidence shows that the increase in fiscal federalism will not best result in the future.

6.2 Basics of Budget Estimates for Federalism

The 10% of annual increase in current expenditure more investment should be made in infrastructure construction increase in capital expenditure by 25% per annum. As return on investment is necessary for a regular source of income, investment should be increased 25% annual growth for financial arrangements.

Table 3. Estimated Budget for Implementation of Fiscal Federalism (Rs billions)

Fiscal Years	Total budget	Federal		Provincial		Local	
		total	%	total	%	total	%
2014/15	467	304	65.10	70	23.03	93	19.91
2015/16	636	413	64.94	95	23.00	127	19.97
2016/17	1049	697	66.44	151	21.66	201	19.16
2017/18	990	644	65.05	149	23.14	198	20.00
2018/19	1139	740	64.97	171	23.11	228	20.02
2019/20	1312	853	65.02	197	23.09	262	19.97
2020/21	1514	984	64.99	227	23.07	303	20.01
2021/22	1753	1140	65.03	263	23.07	351	20.02
2022/23	2037	1324	65.00	306	23.11	407	19.98

Source: Ministry of finance, 2020.

According to Table 3, the estimated budget for implementation of fiscal federalism was presented from fiscal years 2014/15 to 2022/23. The federal government has allocated approximately 65% of the budget to the central government, 23% of the state government and 20% to local governments. The budget allocation scenario shows that to preview the capacity and sustainability of each government, which was linear. The lowest budget of the federal government in fiscal year 2015/16 was 64.94% and the highest was 66.44 in fiscal year 2016/17.

6.3 Status of Intergovernmental Financial Transfers

Table 4. Intergovernmental Financial Transfer (Rs. in Lakh)

Fiscal Years	Equalization grant		Conditional grant		Special Grant		Supplementary Grant		Total	
	Province	Local	Province	Local	Province	Local	Province	Local	Province	Local
2017/18	7143500	148639833	0	76414758	0	0	0	0	7143500	225054591
2018/19	502968	852057	631355	1098456	0	0	0	0	1134323	1950513
2019/20	551950	900550	363557	1610899	31530	68322	51832	47805	998869	2627576
2020/21	579548	945578	358731	1734985	51500	83101	57246	66483	1047025	2830147
2021/22	614321	1621628	571682	1837263	45643	91410	62960	72730	1294606	3623031
Total	9392287	152959646	1925325	82696361	128673	242833	172038	187018	11618323	236085858

Source: Ministry of Finance, 2022.

From the above Table 4, the intergovernmental financial transfer has shown with equalization grant, conditional grant, special grant and supplementary grant for province and Local sectors. The total equalization grant in Province has 9392287 with fiscal years from 2017/18 to 2021/22 and Local level has 152959646. In the same period conditional grant has 1925325 in province and 82696361 in Local government. The special grant has 128673 in Province and 242833 have in Local government. The total budget allocation of province has 11618323 and 236085858 has in Local government. The ration of financial transfer of budget from central government for Local and Province government is 20.3:1. So the volume of intergovernmental financial transfer with local and province for more than twenty's times high.

6.4 A Destination for Improvement

The main purpose of federalism is to end centralized governance and build a prosperous and independent country with equitable, balanced and social justice. However, for this, it is necessary to determine the necessary destination and take strategic improvement steps. During the transitional period, problems and challenges will arise, but such problems and challenges should be addressed in a timely manner and turned into opportunities. For this, it is necessary to take immediate concrete steps in the following areas.

(a) Nepal's federalism is based on the spirit of cooperation, coexistence and coordination. Therefore, it is not appropriate for each level of government to use its rights unilaterally to create and implement laws and regulations. When making laws for the use of economic rights and financial rights, they should be made in such a way that they do not conflict with the federal laws. The Union can make policies, standards and laws that apply to the provinces in the field of economic rights. The budget deficit management and other financial discipline provisions of the Union, provinces and local levels are federal. Constitutional provisions such as those in accordance with the law indicate that the government of Nepal should play the role of impartiality in economic and financial matters.

(b) For the management and transfer of inter-governmental finance, the national natural resources and finance commission as per article 250 of the constitution of Nepal has not been formed, which has created an obstacle in the guidance of the inter-governmental economic and financial system. As the recommendation of the constitutional council and a parliamentary hearing are necessary for its formation, it is necessary to give high priority to the work of forming this commission as soon as the federal legislature is formed. Since the organizational structure of the commission's secretariat and the determination of manpower have been completed, it is necessary to establish the secretariat of the commission as soon as possible before the formation of the commission.

(c) For the successful implementation of financial federalism, it is necessary to prepare related legal structures, procedures, standards and administrative mechanisms at the union, state and local levels. In this process, it is necessary to formulate the laws and regulations related to the separate financial procedures of the union, state and local levels, the laws and regulations related to revenue administration and the laws and regulations related to public procurement under the jurisdiction of the Constitution of

Nepal and the Inter-Governmental Finance Management Act. These laws and regulations are subject to be passed by the legislatures of their respective levels. However, from the point of view of uniformity, it would be preferable for the Nepalese government to make and provide model laws as technical support for the provincial and local levels.

(d) According to the Constitution of Nepal, the list of rights of the union, state and local levels has been arranged and the Nepal government has prepared and approved the work detailing reports of all three levels. In spite of this, some regular projects/program of the local jurisdiction could not be transferred from the current year's budget. On the background of no provincial elections, although the budget has allocated a subsidy amount of 1 billion for each province, none of the programs/projects have been implemented at the provincial level so far. In this situation, it is necessary to complete the following tasks in the current year in order to organize the plan and budget of the provincial and local levels from the next financial year. For this, the Nepal government needs to play the role of a facilitator.

(e) According to the prevailing law of Nepal, the central account of the country's income and expenditure should be prepared by the Comptroller General's Office. In the central accounting statement prepared in this way, the income and expenses of the union, state and local levels should also be shown in an integrated manner. For this, it is necessary to prepare and implement integrated revenue and expense classification signals to bring uniformity in the accounting system of income and expenses at all levels, to develop appropriate accounting frameworks and arrange for the system of income and expense reporting to be obtained through electronic means.

(f) In the absence of reliable economic and financial data at the state and local levels, the work of planning and resource management always becomes difficult and complicated. For this, it is necessary to compile the details in a format that includes the economic and financial details of each province and local level. Identifying the expenditure needs and revenue potential of each province and local level is a prerequisite for the equalization grant, so it is seen that special attention should be paid to this.

(g) It has been seen that the central government has to work as a facilitator to develop the capacity of human resources, to work on the economic and financial management of the state and local levels and to build a system and methodology.

7. Conclusion

Fiscal federalism plays a huge role in the success of federalism. Financial transfers should be aligned with the level of expenditure needs and revenue potential. In particular, the province has very narrow tax authority. There is a need to provide new areas of income for the province and emphasize building internal resources at the local level. There are constitutional provisions for financial transfers, especially distribution of equalization grants, according to expenditure needs and revenue capacity. For this, according to the constitution and laws, the province and local level should be responsible for the expenses incurred. Similarly, according to the revenue rights received by the state and local level, the

potential revenue should be assessed and the financial gap should be studied in detail and implemented. Revenue capacity varies by state and local level. It requires a lot of effort and effort to systematically study and implement it. In order to strengthen federalism in Nepal, all possibilities of economic development should be opened, including the highest utilization of resources. The responsibilities including the distribution of financial resources and the transfer of finance should be clarified in order to integrate the resources at the local level, state and federation, into the main stream of development. If this is not done, the tendency to focus on the areas where the money is made and the areas where the expenses are to be spent will increase, and it will affect the entire government system of operation.

The amount of financial transfers and revenue sharing provided by the Government of Nepal is also linked to good governance. Proper use of state funds can only be achieved if the work and resource mobilization and spending are linked to the productivity of the state and local levels. There are also local levels that do not pass the budget. Therefore, it seems necessary to adopt a performance-based financial transfer system. Efficient use of allocations is essential in an environment of resource constraints. The government's at all three levels are seen as weak in budget spending. The size of the deficit as a proportion of local level expenditure is above five percentage points. Therefore, allocation efficiency and expenditure effectiveness must be increased. The share of equalization grants in financial transfers should also be increased. It is more appropriate to transfer funds through financial grants according to the constitution rather than partnership programs with various names that are not recognized by the constitution and laws, as the central decision dominates the jurisdiction of the provinces and local levels.

Conflict: There is no any conflict of interest of this study.

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